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27 March 2014

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Commissioners

RRC0001: National Energy Retail Amendment Rule 2014

Thank you for the opportunity to respond to the Consultation Paper on the above review.

Simply Energy does not support this Rule change request for the following reasons:

- The AEMC does not have the jurisdiction to consider the content of this Rule change and thus it is not a valid Rule change request.
- Energy retail price variations are subject to existing regulation and this Rule change is not required.
- The Rule change proposal does not demonstrate a clearly defined problem.
- The Rule change proposal fails the National Energy Retail Objective (NERO) and the customer protection test.

AEMC does not have the jurisdiction to consider the content of this Rule change

The content of this Rule change is attempting to impose price regulation on fixed term contracts. If accepted, the Rule change would prevent a retailer from varying the price of a fixed term contract during the term of that contract. This is price regulation.

The *Australian Energy Markets Agreement 2011* preserves the decision on whether price regulation should be imposed or removed to State Governments. In effect, the Rule change proposal is attempting to usurp the authority vested in State Governments to make this decision.

We question the AEMC's jurisdiction to decide on whether the prices of fixed term contracts should be subject to price regulation.

For this reason, we believe the AEMC should re-consider accepting this proposed Rule change as a valid Rule change request.

Energy retail price variations are subject to existing regulation

How a retailer varies prices during the term of a contract is subject to regulation from the Australian Consumer Law (ACL) and Rule 64 of the National Energy Retail Rules (NERRs).

Application of the ACL

The Consumer Utilities Advisory Centre (CUAC) and the Consumer Action Law Centre (CALC) claim that the ACL does not apply to energy retail price variations, given the existence of Rule 46 in the NERRs.

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CUAC and CALC consider that Rule 46 expressly permits retailers to include terms in market retail contracts that allow for price variations during fixed periods.

This is not a correct interpretation of Rule 46.

- Rule 46(2) states that a contract must contain all tariffs and charges.
- Rule 46(3) states that a retailer must give notice of any variation to those tariffs and charges.

Rule 46(3) places a requirement on the retailer to notify customers of a price variation. It does not expressly permit retailers to include terms that allow for price variations.

As the NERR does not expressly allow retailers to vary tariffs and charges, any terms relating to the variation of tariffs and charges will be covered by the unfair contract terms of the ACL. As a result, the Rule change is not required, as consumers are already protected by the ACL from inappropriate variation to tariffs and charges.

Rule 64 of the NERRs

Rule 64(1)(a) of the NERR requires a retailer (or its marketer) to inform customers of all applicable prices and how they may be varied. Rule 64(1)(a) states:

> (1) The required information that a retail marketer is to provide to a small customer is information in relation to the following:
> (a) All applicable prices, charges, early termination payments and penalties, security deposits, service levels, concessions or rebates, billing and payment arrangements and how any of these matters may be changed.

As a result, retailers are already required to inform customers of the potential for prices to vary during the term of a contract.

The Rule change proposal does not demonstrate a clearly defined problem

To support their Rule change proposal, CUAC and CALC rely on a single case study (Customer X) and a theoretical economic piece.

We do not believe that this is solid enough evidence that a problem exists. The AEMC's own analysis for the NSW Competition Review shows that only around 2% of electricity customers (1 in 50) were dissatisfied after switching due to price rises. For gas, the research indicated that no customers were dissatisfied.[1]

The Rule change proposal fails the NERO and the customer protection test

The Rule change proposal fails the NERO because it threatens to break the nexus between the prices that customers pay and the social cost of production, and thus does not fulfil the NERO of ensuring efficiency in investment, operation and use of energy.

It also fails the customer protection test because it will be detrimental to customer outcomes:

- It will increase costs for customers. The likely outcome if this Rule change is made will be shorter average contract lengths. If prices cannot be varied for any reason during a contract, then contract

[1] AEMC 2014 National Energy Retail Amendment (Retailer Price Variations in Market Retail Contracts) Rule 2014, Box 6.2, p. 41

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lengths are likely to be reduced, to align them with the period during which network and other costs are to some extent foreseeable. Shorter contract lengths will lead to customers incurring higher search and transactions costs, as they will have to re-contract their energy supply more frequently.

- It will reduce choice. If retailers are not willing to bear the risk of long term fixed price contracts, then these types of contracts are likely to disappear from the market, leaving only shorter contract lengths. This will reduce customer choice. It may also threaten the continued existence of more sophisticated product offerings such as bundled solar products or products that link changes in the retail price to changing wholesale prices. The potential also exists for longer term contracts to disappear from the market. This will reduce the range of products available in the market and reduce customer choice.
- It will increase price risk for consumers. The success of a purchasing decision could be more closely linked to the timing of the purchasing decision.
- Where longer term contracts remain, it has the potential to increase bill shock. At the end of each contract, customers could experience significant change in the retail price as the price re-aligns with industry costs.

We expand on each of these points in our main submission.

We are also concerned about the impact this Rule change proposal would have on a retailer's decision to roll out smart meters and associated services. Shorter contract lengths change the business case for rolling out smart meters because it reduces the certainty that a retailer has over the return from the investment.

I would be delighted to discuss with you the views expressed in this submission if you believe this would be of assistance. I can be contacted on (03) 8807 1132.

Yours sincerely

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Submission to the National Energy Retail Amendment Rule 2014

This submission is in three parts. Under Part A, we respond to the assessment framework that the AEMC has established to assess changes to the NERR. In Part B, we respond to the AEMC's Consultation Paper and in Part C we respond to the application made by CUAC and CALC.

PART A: THE AEMC'S ASSESSMENT FRAMEWORK

The NERO states:

> The objective of this Law is to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy.

Any Rule change proposal will need to demonstrate that it will:

- Promote efficient investment in energy services over the long term
- Promote efficient operation of energy services over the long term
- Promote efficient use of energy services over the long term
- Promote consumers' interests with respect to price, quality, safety, reliability and security over the long term.

The AEMC states that competitive markets provide the best means of promoting efficiency and has established a set of criteria that it considers reflect the characteristics of a well-functioning competitive market:

- Efficient allocation of costs and risks,
- Effective consumer engagement and participation,
- Provision of a range of products and services consumers value
- Independent rivalry and competition between retailers

To an extent, we agree with the AEMC's approach because competition in the retail sector is important for ensuring efficient outcomes as prices adjust to reflect efficient costs and customer choices.

However, the assessment will also need to factor in how the Rule change will impact efficiency across the entire energy sector.

Flexible retail prices create signals about efficient use of energy by consumers and efficient investment in and production of energy upstream of the retailer.

The retail price sends signals to the end consumer about the opportunity cost of the resources invested in supplying the consumer with an amount of energy at a particular time, so that the consumer only consumes if the value of that use exceeds (or is at least equal to) the social cost of production. If retail prices cannot vary in response to changes in the social cost of production, then the consumer will not always be making an economically efficient choice about their use. This in turn will have consequences for the investment decisions made by networks and generators.

The retail price also sends signals to networks and generators about how and when they invest in and operate their assets.

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As a result, for the AEMC to adequately assess the Rule change proposal against the NERO it is necessary, but it is not sufficient, to evaluate the competitive nature of the retail sector. The AEMC will also need to consider how a proposed Rule change will promote efficient investment and operation of generation and network assets as well as the implications it may have for the consumption choices made by the end consumer.

PART B: RESPONSE TO THE AEMC'S CONSULTATION PAPER

In this Part, we respond to the AEMC's Consultation Paper, in particular Chapters 5, 6, 7, 8 and 9 of that Paper. We have followed the structure of each of these chapters as presented in the Paper.

1. Allocation of costs and risks (Chapter 5)

In this section, we respond to the AEMC's commentary and questions concerning the allocation of costs and risks in market retail contracts. We comment on retailers' strategies for managing risks, risk allocation in market contracts and the implications of the proposed Rule change for the allocation of costs and risks.

1.1 Retailers' strategies for managing risks

The AEMC provides a good analysis of how a retailer manages risk and how much control a retailer may have over its costs.

Regulated network costs

The AEMC correctly highlights that a retailer is a price taker of the distributors and has limited (if any) ability to hedge the variability that can occur in network tariffs from one year to the next.

There are two other aspects of distribution tariffs that the AEMC should bear in mind when considering whether a retailer can better predict and manage the risks of changes in network tariffs, even with the AEMC's current work on electricity network tariff structures and determination timings.

The first aspect to be aware of is that distribution networks are able to mandatorily reassign customers from one tariff type to another at any time.[2] For example, a particular customer can be reassigned from a flat rate/standing charge network tariff to a time of use tariff (subject to the necessary metering being in place) at any time. The networks perform these reassignments without any notification to the retailer or the customer.

A retailer's contract with the customer must provide for the pass through of the impacts of this change, otherwise the retailer will bear the cost of much higher network prices during peak times. The peak time network prices are likely to exceed the amounts recovered from the customer through the retail tariff. If mandatory reassignment occurs on a mass scale, a retailer could be potentially become loss making as its revenues no longer recover the costs it is incurring.

Restricting a retailer's ability to pass through these price signals is also counter to the Standing Committee on Energy and Resources' objective of end customers receiving better pricing signals about the cost of their use of the network.

A second aspect to consider is the intention of the Australian Energy Regulator (AER) to transition the distribution networks from a weighted average price cap to a revenue cap.[3] Without an effective smoothing path, variable demand growth means that network prices may need to change significantly from one year to the next year, so that distributors do not over- or under- recover network costs. As a result, network prices will become even less predictable for a retailer than is currently the case.

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[2] The exception to this is in Victoria where a temporary moratorium on mandatory reassignment has been instituted in the transition to flexible pricing.

[3] We note that the AER is consulting on this matter as each network's price path comes up for review and the AER may retain a weighted average price path for some or all distributors depending on the outcome of its consultation process.

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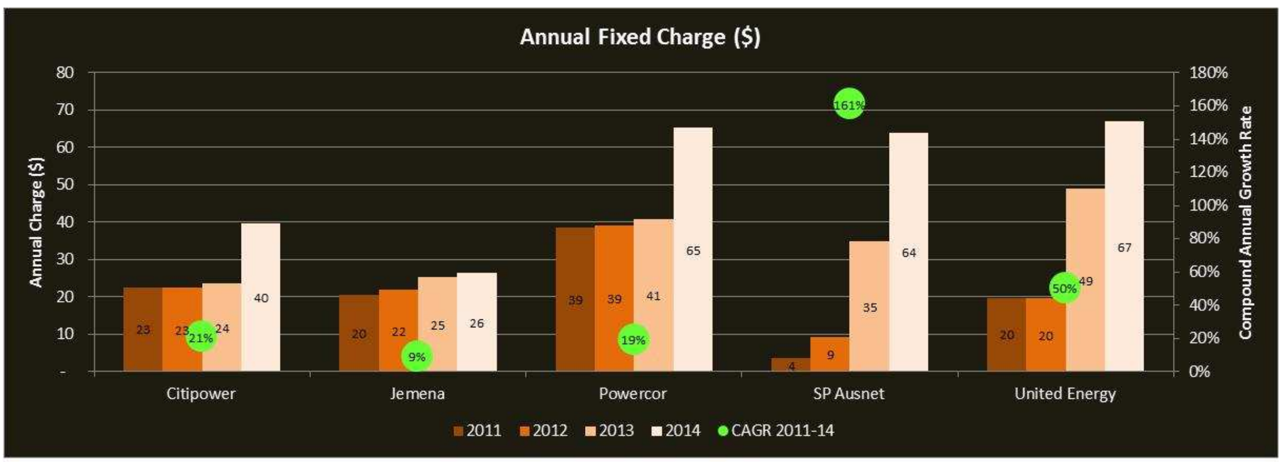
CUAC and CALC comment that retailers should be able to manage network costs because a five year price path is established.[4] This does not demonstrate a solid understanding of what a network price path is and how it works.

As the AEMC is aware, the price path determines how the bundle of network tariffs will change as a whole from one year to the next. It does not set out how the individual tariffs within that bundle will vary from one year to the next to meet the limits set by the price path. Nor does the price path set out how the structure of individual network tariffs will change annually.

Despite a smoothed regulated price path for the bundle of network tariffs, a retailer can experience highly volatile network pricing and pricing structures from one year to the next. As an example of this volatility, we have set out in the following diagram how the annual fixed charges levied by the Victorian distribution networks have varied over the last four years.



A retailer has no control over the level or structure of a distributor's tariffs and has no transparency on how the level and structure will change in future years. As a result, claims that a retailer should be able to manage network costs because a five year price path is set are not correct.

Government policy costs

The AEMC correctly points out that a retailer will have different levels of control over the costs of government policy changes depending on the nature of the policy.

However, the AEMC does not recognise that the greatest concern for a retailer is the variability and unpredictability of changes in government policy. The industry often suffers from unheralded policy changes and it is retailers that suffer the most from this.

Even with existing policies there are frequent reviews and changes so that a retailer never experiences a settled regulatory environment.

[4] CUAC/CALC 2013 Unilateral Price Variation and Market Retail Contracts: Rule Change Request for Australian Energy Market Commission, p. 6

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As a result, retail contracts need to allow for the pass through of the costs resulting from policy and regulatory changes. They represent costs that society has decided to impose on retailers and they are beyond the control of retailers.

Other uncontrollable costs

The AEMC focusses its discussion on risks arising from energy-specific issues, policies and regulations. However, as corporations, all sectors of the energy industry are also affected by changes in more generic policies and regulations. For example, changes in Corporate Tax Law and accountancy requirements all have an impact on each sector of the energy industry and end up affecting the final energy price paid by the customer.

Uncertain events

The AEMC does not refer to the wide range of uncertain but high impact events that a retailer must manage when they occur. Some examples of these are:

- Failure in the wholesale market that results in the wholesale price reaching VOLL for a sustained period
- A ROLR event
- Wide spread network outages

It is important to consider the potential for these types of events to occur and how they would be managed by a retailer if the Rule change is made and retailers are unable to vary prices to customers on fixed term contracts.

1.2 Risk allocation in retail market offers

The AEMC questions whether the current Rules result in an efficient allocation of risks between retailers and consumers in retail energy markets (Question 3).

Simply Energy considers that the current Rules, in conjunction with competitive market discipline, are resulting in an efficient allocation of risks between consumers and retailers.

The competitive market means that retailers have strong incentives to manage risks for consumers when it is cost effective for them to do so. For example, consumers do not want to be exposed to wholesale price fluctuations, and retailers manage this risk for them. Retailers are able to manage this risk efficiently because there are counterparties who are prepared to contract with retailers for part of the risk.

The current Rules, supported by the ACL, have worked to allow retailers to offer contracts that include terms that allow variation of prices and charges under certain circumstances. This is used to allocate part of the risk from changes outside the retailer’s control (such as individual network tariff changes and reassignments, and the impact of regulatory changes) to consumers.

This is efficient because network and regulatory scheme costs (such as RET, REES, VEET) are pass throughs that all retailers must pay on behalf of consumers. Policy makers and the AER are responsible for the impacts of network charges and regulatory schemes on consumers. Retailers are merely the mechanism for recovery of these costs from consumers.

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1.3 Implications of the proposed Rule change

The AEMC questions whether the proposed Rule, if made, would result in a risk premium being built into fixed period contracts, how significant this premium would be and would it create a permanent increase in the price of fixed period contracts (Question 4).

If the proposed Rule is implemented, a retailer would need to build a risk premium into the price of fixed term contracts and it is likely that this premium would be very large given the large proportion of costs that are uncontrollable for a retailer. The upfront price charged would need to factor in a whole range of uncertain costs:

- Failure in the wholesale market that results in the wholesale price reaching VOLL for a sustained period
- Changes in network prices
- New and changed government policies
- New and changed taxation arrangements
- New and changed accounting standards
- Network cost pass throughs approved by the AER
- Costs associated with an unanticipated ROLR event

The price customers pay will reflect these potential costs even though the events may not occur during the term of the contract.

We are not convinced that this potential outcome is consistent with the National Energy Retail Objective (NERO).

2. Consumer participation and engagement (Chapter 6)

Customer engagement with the market is important for the outcomes experienced by the individual customer and for the competitive outcomes delivered by the market as a whole.

However, energy is a low engagement product and no amount of information is going increase customers' excitement levels with respect to shopping around for a better energy deal. Energy is not a product that customers want to spend a great deal of time on to understand and compare various offers.

To date, regulations have focussed on requiring retailers to provide ever increasing amounts of information to customers in the hope that the next piece of information will be the one that gets customers excited about their energy supply and actively engaged in the market.

In our view, retailers are now required to provide so much information that it is overwhelming customers and detracting from their willingness to engage with the industry. Much more information is provided than that needed to make an effective purchasing choice, and the amount of information is discouraging customers from engaging (given that their interest in the product is low to begin with).

2.1 Information and efficient retail energy markets

The AEMC must take care not to misrepresent the results of the Roy Morgan Research as presented in Box 6.2.

On face value, the wording in Box 6.2 would suggest that 17% of electricity customers surveyed were dissatisfied with their new energy company due to prices rising after signing or switching to a new contract.

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However, this is only 17% of the customers dissatisfied with their new energy company after switching (13% of the 100% surveyed).

17% of 13% equates to 2.2% of the 100% of customers surveyed — 2.2% of electricity customers (1 in 50) were dissatisfied after switching due to price rises.

This is not a significant number and does not suggest a wide-spread undercurrent of dissatisfaction with price rises occurring after switching. For gas, the percentage would be even less and may even be zero — no customers were dissatisfied with price rises after switching.

Transparency and market retailer contracts

In Question 5, the AEMC asks whether consumers:

- when entering fixed period contracts believe that the prices will be fully fixed when in fact they are not, and
- are unaware that fixed period contracts with fully fixed prices are available on the market.

In relation to the first question, we find this unlikely given that Rule 64(1)(a) of the NERR requires a retailer (or its marketer) to inform customers of all applicable prices and how they may be varied.

In relation to the second question, fixed price products have been widely advertised through mass media outlets and also loaded up onto the various regulator-sanctioned price comparators such as energymadeeasy, YourChoice and Switch On.

2.2 Barriers to participation

The AEMC states in relation to fixed period contracts that incur exit fees that:

> "If this is the case, there is a risk that retailers could increase prices in fixed periods by a greater amount than would be the case if these barriers to participation were smaller or did not exist competitively when raising prices during fixed periods as a result of the reduced risk that consumers will change their retailer or contract."[5]

This statement is not a fair reflection of how a prudent retailer sets its prices. A prudent retailer is always conscious of its obligations under the Australian Consumer Law when setting its prices and pricing structures. We believe a retailer engaging in the type of behaviour described would attract the attention of the Australian Competition and Consumer Commission and would be susceptible to claims of anti-competitive behaviour.

Question 6 in the Paper asks whether the ability for retailers to vary prices leads to a perception amongst consumers that changing to a new retailer or contract would waste search costs, and to what extent exit fees and other transaction costs might affect consumer behaviour after a price variation.

Search costs and transactions costs are a feature of any market and are proportional to the competitive state of a market. The more competitive the market, the higher are the search and transactions costs for consumers because there are more suppliers, products and prices to compare. By inference, if regulation attempts to reduce these costs for consumers, it will usually result in less competition because it typically means that regulation is attempting to reduce diversity in the products and prices that suppliers offer. The reduction in

[5] AEMC 2014, p. 44

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competition experienced in the UK market as a result of the "tariff reforms" introduced into that market is evidence of this.

The question that the AEMC is really aiming to address is whether the search and transactions costs that customers incur in participating in the competitive energy retail market are out of line (in other words, inefficient) compared with the benefits they receive from that investment.

This is an extremely difficult question to answer. First, it will depend upon the individual customer and how much they value the benefit derived from searching and transacting another energy deal. If a customer is not interested in what they pay for their energy supply, then the benefit will be of little value relative to the cost of changing their supplier. This is an efficient outcome as the customer has maximised the opportunity cost of their time and resources.

Second, the outcomes achieved by a customer can change over time as the customer learns about the market and how to participate in it. A customer's initial search for a new energy contract may be more costly than subsequent searches as they have to educate themselves about the suppliers, products and prices available and understand what each of the available options means for their own circumstances. Again, this is an efficient outcome because the costs of the search and transaction may be high at the start but they fall with time and experience, and the benefits grow as the customer learns and makes better decisions.

There have been claims about the existence of information failures in the energy market before, and questionable policies intended to correct these failures have been implemented. A significant proportion of the NECF appears to be designed to eradicate these supposed information failures, yet claims of customer confusion abound.

Each new policy never fixes the supposed failure and only seems to make the failure worse, because the claim of information failure is accepted without any substantive evidence presented to justify the claim. New information requirements are introduced but, in the end, they end up overwhelming the customer. They increase search and transactions costs and make the energy purchase decision unnecessarily time-consuming and complicated.

Our experience with customers is that they are very savvy — they know their rights, they are able to find the information they need, are sceptical of offers that seem too good to be true, and are ready to switch if they find a better offer or a retailer that provides them with the service they expect.

In considering this question, it may be pertinent for the AEMC to re-consider the whole question of what information consumers need to make an effective energy purchasing decision. This would refocus the debate on genuine market failures and provide much-needed guidance to policy makers on what a sensible minimum set of information requirements is that enables a customer to make an effective purchase decision.

In our view, if there was less regulation and retailers were allowed to compete on the quantity and type of information that they provide to customers, the outcomes that customers experience would be vastly improved.

2.3 Impacts of the proposed Rule

Beyond price, there are other implications that this Rule change may have and which we believe will result in the failure of the Rule change proposal achieving the NERO. These include:

- Increased price risk for customers
- Shorter contract lengths and higher exit fees

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- Increased price shock if longer term contracts remain in the market

Rather than reduce price risk, the Rule change will likely result in increased price risk for the customer. The nature of the risk that the customer will take on is time-based. Whether a purchase decision today is a good decision depends on what happens to prices tomorrow. If prices rise tomorrow, then the purchase decision made today was a good one. If they fall, the purchase decision was a poor one but the customer is locked into the purchase decision made on that day. The customer must now time the purchase decision well to maximise the outcomes of that decision. To do this, the customer now needs to have knowledge of how costs and prices across the energy industry will change over time, vastly increasing their potential search and transactions costs.

The proposed Rule change may also mean that fixed term contract lengths become shorter and exit fees become higher. As the AEMC will be aware, exit fees recover at least part of the cost that a retailer has incurred in acquiring the customer should the customer not remain with the retailer for the expected period of time. This allows a retailer to offer the customer a lower energy price because the retailer can still recover its customer acquisition costs should the customer terminate the contract early. If contract lengths are shortened, then either the energy price or the exit fee on the shorter term contract must rise so that the retailer recovers its acquisition costs (which are independent of the length of the contract).

Combined, these two likely outcomes mean that if the customer times their purchase decision badly, they may face hefty exit fees to improve their situation. It will also result in higher search and transactions costs for consumers because they will have to re-contract for their energy supply on a more frequent basis than they currently have to.

If longer term contracts remain in the market after this Rule change, it is likely that customers that wish to minimise their search and transactions costs by taking advantage of longer length contracts will suffer bill shock. If they remain on the same price for two years, then the price they face at the end of the contract could be very different from the price they have been paying.

Our direct experience in the market suggests that customers prefer slow and steady changes in their energy price rather than large but infrequent changes in the price they pay. Our complaint levels and Ombudsman cases increase in number when energy prices are changing by large amounts at a point in time. Customers are better able to manage and budget for slow steady changes in prices and do not understand why their bill has suddenly changed significantly if large prices rises are flowing through.

While we do not have concrete evidence, the desire that customers have for slow and steady changes in prices rather than infrequent large changes could provide an explanation for why fixed price contracts are not more popular in the market.

3. Competition between retailers

3.1 Impact of the proposed Rule upon competition between retailers

The AEMC questions how the proposed Rule change would affect competition and whether it would make it more difficult for new entrants to enter the retail market (Question 8).

As this Rule change proposal is nothing more than an attempt to introduce price regulation, the impact on competition is likely to be as deadening as explicit price regulation is to competition.

Additionally, the impact of the proposed Rule change may be greater on second tier than first tier retailers, which would impair competition to the detriment of the long-term interests of consumers. First tier retailers

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have groups of customers that do not participate actively in the market and are content to remain on legacy contracts. As a result, first tiers may have a greater capacity to absorb some of the cost risks that this Rule change would impose than second tier retailers whose contracts are typically fixed term contracts.

3.2 Innovation in retail market offers

The AEMC asks whether the proposed Rule would cause retailers to withdraw or offer shorter fixed period offers from the market (Question 9a).

As discussed in section 2 of this submission, a retailer would likely offer much shorter fixed term contracts at a much higher price.

We are also concerned about the impact this Rule change proposal would have on a retailer's decision to roll out smart meters and associated services. It would change the nature of the business case as there would be less certainty over the return on the investment made.

4. Consumer protection issues

4.1 Interactions between the Rule change request and the ACL

CUAC and CALC claim that the ACL does not apply to energy retail price variations given the existence of Rule 46 in the NERRs. They argue that Rule 46 expressly permits retailers to include terms that allow for price variations during fixed periods in the market retail contracts.

This is not a correct interpretation of Rule 46.

- Rule 46(2) states that a contract must contain all tariffs and charges.
- Rule 46(3) states that a retailer <u>must give notice</u> of any variation to those tariffs and charges.

Rule 46(3) places a requirement on the retailer to notify customers of a price variation. It does not expressly permit retailers to include terms that allow for price variations.

Applying a correct interpretation of Rule 46 means that the unfair contract term provisions of the ACL will apply regardless of the existence of Rule 46 and consumers retain the protections under the unfair contract terms provisions.

4.2 Interactions between the Rule change request and jurisdictional regulations

The content of this Rule change is effectively attempting to impose price regulation on fixed term contracts. Regulations would prevent a retailer from varying the price of a fixed term contract during the term of that contract. To us, this is a form of price regulation.

The *Australian Energy Markets Agreement 2011* preserves the decision on whether price regulation should be imposed or removed to State Governments. In effect, the Rule change proposal is attempting to usurp the authority vested in State Governments to make this decision.

We question the AEMC's jurisdiction to decide on whether the prices of fixed term contracts should be subject to direct regulation.

For this reason, we believe the AEMC should re-consider accepting this proposed Rule change as a valid Rule change request.

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5. Alternative approach to the issues identified in the Rule change request

5.1 Impacts of the proposed Rule change

In Question 12, the AEMC asks about the impacts of the proposed Rule change and, in particular, asks whether the proposed Rule is a proportionate and appropriate response to the issues identified by CUAC and CALC.

We disagree that it is proportionate and appropriate because CUAC and CALC have not demonstrated that there is a clearly defined problem to solve. There is no evidence presented in their proposal that would suggest there is a widespread discontent over prices changing during the term of a contract.

However, there would be widespread discontent if retailers' costs fell (such as following the removal of the carbon price) and retailers were not permitted to pass these on, or if customers found significant price variations at contract end as the retail price caught up with the cost of supply (i.e. bill shock).

5.2 CUAC and CALC's alternative Rules

We do not support any of the alternatives proposed by CUAC and CALC because CUAC and CALC have not provided any evidence to suggest there is widespread discontent over prices changing during the term of a contract.

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PART C: RESPONSE TO CUAC AND CALC'S APPLICATION

CUAC and CALC's application sets out a suite of problems that the proposed Rule change would address:

- Information asymmetry
- Pricing leading to unsustainable consumption choices
- Search and transactions costs
- Trust in the market and perceptions of fairness

CUAC and CALC also consider that retailers are better placed to manage the risk of changing prices, and the proposed Rule change reflects this view.

In this Part of our submission, we respond to the views put forward by CUAC and CALC.

Retailers better placed to manage risk of changing prices

CUAC and CALC consider that retailers are unilaterally able to pass through rises in input costs, meaning that these risks are currently borne by consumers. They consider that retailers are both more able to manage these risks, and have greater incentives to do so.

This is only partly correct. It is true that a retailer will have an incentive to manage well those costs that it has some control over. In a competitive market, a retailer will set its final retail price taking into account its competitive position. The better a retailer is able to manage upstream costs and its own costs, the better will be its competitive position in relation to other retailers and thus the more successful it will be in retaining and acquiring customers.

CUAC and CALC's views ignore the concern a retailer has over its competitive position, and overlook the fact that retailers do not have full control over upstream costs.

Furthermore, it is unlikely that any retailer will be in such a dominant position that it can "unilaterally pass through rises in input costs". If this were true, then hedging contracts and other tools a retailer uses to manage its costs would not exist. Retailers generally pay more for hedging contracts (than the expected value of the energy purchases they hedge) because of the certainty they offer. If a retailer could unilaterally pass through the wholesale market clearing price (even when that price reached VOLL) without any concern for its competitive position, then hedging contracts would have no value.

As we have discussed in Part B of this submission, CUAC and CALC are also incorrect in stating that retailers are able to control all upstream costs.

Information asymmetry

CUAC and CALC consider that retailers have more knowledge of expected future prices than customer do.

This is not completely true. A retailer will have better knowledge than customers but a retailer does not have perfect knowledge. A retailer faces a range of uncertainties over future costs and we have highlighted a range of these in Part B of our submission.

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Pricing leading to unsustainable consumption choices

CUAC and CALC claim that a retailer can initially set prices below competitive levels to attract customers but then raise prices above competitive levels afterwards.

It is important to distinguish between an observed outcome of price adjustments arising from cost changes and a deliberate customer acquisition strategy by a not-so-prudent retailer.

Customers can experience price changes after they have contracted with a retailer because some new cost has been imposed or some cost component has changed. The obvious example is changes in network tariffs which occur annually. If a customer contracted in the weeks leading up to a network tariff change, then they may experience a change in the retail price they are paying after their contract for supply commences. While we do not know the facts around the Customer X case study, our guess is that this is what has happened to Customer X.

In the second situation, a retailer is potentially engaging in predatory pricing for the purposes customer acquisition. While this is potentially in breach of competition laws, the more important point is that this is unlikely to result in a good customer experience and it is unlikely the customer will seek to re-contract with that retailer or recommend that retailer to others. It damages the competitive position of that retailer.

Existing regulation and market outcomes are sufficient to address this theoretical problem and further regulation like this Rule change proposal is unnecessary.

Search and transactions costs

CUAC and CALC consider that removing the need to inspect terms and conditions to determine whether a 'fixed term' contract is in fact fully fixed would reduce search and transactions costs.

We would not support any change that would encourage customers to ignore the terms and conditions of a contract they are entering into.

That said, the change proposed by CUAC and CALC will likely increase search and transactions costs for customers. The likely outcome is that longer term contracts will disappear from the market and thus customers will have to re-contract for their energy supply on a more frequent (probably annual) basis. Customers will still experience annual price variations but will also incur higher search and transactions costs.

Trust in the market and perceptions of fairness

We doubt that the Rule change will have any demonstrable impact on the opinion that customers have of retailers because customers will still experience annual price changes. If anything, it will likely make the situation worse as customers will not only experience a price change but will also have to incur further search and transactions costs in signing up to another market contract.